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CENTRAL BANK—DISCUSSION.

HORACE WHITE: Something must be done to put an end to the periodical suspensions of the banks. The greatest evil attending them is the bad education they give. They tend to deaden the sense of commercial honor. Every such suspension is a license to every financial institution to scale its debts or postpone the payment of them. They assume the right to pay or not to pay according to their convenience. Some banks in such cases pay their own debts and those of their weaker neighbors also. Others refuse to pay even when they are able to. Each is a law unto itself for the time being, and the time is indefinite.

While the chaos continues the banks assume the right to pay their obligations with something which is not money. They pay with a rubber stamp, which is elastic in a double sense. Sometimes it is worth 100 cents, sometimes 90 or any price between. One day in the recent panic I went into the bank where I kept an account, and, meeting the president of it, I remarked to him that I had bought a small amount of currency in Wall Street at a premium of 4 per cent. He replied that it was lucky I was not compelled to buy a large amount, as he had just witnessed a purchase of \$500,000 at a premium of 6 per cent. If the purchaser in this case had required a million the premium might have been 10 per cent.

When the banks thus repudiate their obligations their depositors can hardly do otherwise. Frequently they are compelled to pay their workmen with stamped cardboard, which the latter force upon retail shopkeepers and street

peddlers at a loss to both payer and payee. All these things are done in disregard of law and in defiance of it. These breakdowns have been so frequent in the past fifty years that they are now regarded by many well-meaning people as a part of the natural course of things. Clearing house certificates and rubber stamps are looked upon as desirable *per se*—as something like Pond's Extract, or Peruna, which should always be kept in the house. The public mind is approaching the condition which prevailed in antebellum times, when banks that were under suspension continued business for years and actually declared dividends when they were not paying their own debts, and so continued until compelled by special acts of the legislature to resume. In short, these repeated occurrences tend to legalize commercial dishonor. We are already discredited abroad by them, and they are teaching the rising generation that a general suspension, with its progeny of illegal shinplasters, is a dexterous method of avoiding bankruptcy instead of being a shameful confession of it.

Another demoralizing effect of it is that when a crisis comes the speculators, who are most to blame for it, clamor for government aid. So common is this, and so vociferous and so generally expected, that the government even runs ahead of the speculators and offers help before they ask it. The remedy, however, may be only a prolongation of the disease. At all events the specimen given to us of this kind of government aid in the recent panic should serve rather for a warning than for an example.

What is it that makes clearing house certificates, and stamped cardboard, and a premium on currency necessary? The panic, of course. A trade reaction, and a bank panic, although closely allied, are two different things. Canada had a trade reaction last autumn, as se-

vere, and of the same kind, as our own, but she had no panic. Most of the countries of Europe had trade reactions akin to ours, but no general bank suspensions and no runs on banks by depositors, or by banks on each other. We had runs of both kinds, beginning with the latter.

The run by the depositing banks on the reserve banks began about a week before the individual depositors learned that there was any trouble. And after the individual depositors took the alarm their demands upon the banks were more moderate than those of the banks upon each other. The danger of suspension to a banker is more imperious and terrifying than to an individual. To the banker it is a leap in the dark. He will avoid it by every means possible. The instinct of self-preservation prompts him to fortify himself with cash, and to this end he draws the balances which he holds in other banks. Each one thinks that if he should refrain from doing so others would not. Would his depositors applaud him for sacrificing himself and them for the general good? On the contrary, they would call him a fool and would transfer their accounts elsewhere.

The first step toward reform is to take away the motive which impels the banks to make runs upon each other. How is this to be done?

The main difference between ourselves and those countries which did not have a panic and general suspension last year was that we had greater resources with inferior bank credit, while they had inferior resources with greater bank credit. The wealth of Canada is much less than ours. Moreover, the wheat crop of Canada last year was in part frosted and under suspicion, while ours was sound. Yet Canadian bank credit was not shaken. The banks did not make runs on each other, therefore the pub-

lic did not make runs on the banks. There are no country banks in Canada as we understand that term,—only branches of thirty-five city banks, the heads of which are near enough to each other to secure unity of action.

In European countries generally credit is fortified by a central bank, which has the power of issuing circulating notes limited only by its cash reserve and its commercial assets. Usually the central bank is allowed to establish branches at its own discretion. Its principal function is to discount any and all bills of exchange which bear two or more names and which represent actual business transactions. The fact that there is such a bank easily accessible is a guaranty that no sound business can suffer for the want of banking accommodation, and that every secondary bank can get its own bills of exchange re-discounted, if need be. Therefore the ingredients of a panic do not exist. Speculators may fail, unsound business may collapse, but there will be no clearing house certificates, no stamped cardboard, no premium on currency.

If there is any way to abort a panic before it begins, other than the branch bank system of Canada, or the central bank system of Continental Europe, I do not know what it is. Which of the two ought we to prefer?

If we had *carte blanche*, if we were now beginning to create a system, I should certainly choose the Canadian plan, because we know exactly how that system works in a territory like our own, which is in part populous and wealthy, and in part scattered, thinly peopled, and relatively poor. But the branch system of Canada is the very *bête noire* of our rural banking fraternity. I participated in a joint debate on branch banking a few years ago at a bankers' convention in Kansas City. I favored branch banking and my competitor opposed it. It seemed

to me that I had all the argument and he had all the votes. I became satisfied that branch banking can never be introduced in this country until the bankers of the smaller communities are convinced that they will not be snuffed out or materially harmed by branches of the large city banks established alongside of them. You can never induce Congress to vote for anything that the small banks are generally and strongly opposed to.

The central bank system, to be really efficient, must be allowed to have branches also, and to choose the places where they shall be situated, but it is not necessary that these branches should compete with local banks for local business. The very *raison d' être* of a central bank is to lend aid to local banks, to re-discount for them and to fortify bank credit generally, so as to prevent panics and runs. Moreover, it is practicable to make the local banks the owners of the central bank, so that its power to do them injury (if it could ever have a motive for doing so) would be nil. It is also practicable to have the government control the central bank either partially as in France, or wholly as in Germany.

Time does not permit me to go into details, and I acknowledge that this question is one mainly of details. How to make the benefits of the central bank ramify all parts of the country is a problem to be solved. I do not affirm that it can be done. Neither can anybody affirm that it cannot be done. It is a problem fit to engage the attention of the present Currency Commission and I am glad to know that they appreciate both its relevancy and its magnitude.

JOSEPH FRENCH JOHNSON: I am in agreement in the main with what has been said by Mr. Warburg and Mr. White, but am not altogether in harmony with the views

and opinions expressed by Professor Sprague. In my opinion the panic of October, 1907, was due, not to the policy followed by the banks in New York City, but to the weakness of our banking system as a whole. The bankers of New York are as able and prudent as the bankers of any city in the world, and they did all that any set of men in their positions could have done to avert the panic. They were unsuccessful simply because it was not possible for them, except by suspension of cash payments, to prevent the banking reserve of the country from being scattered and thereby made ineffective.

The greatest defect of the banking system of the United States is its lack of unity and solidarity. This defect can be remedied either by the adoption of a branch banking system or by the establishment of a central bank under government control. Branch banking is not in favor in this country for the reason that the thousands of small banks in the country naturally regard it as antagonistic to their interests. On account of their opposition any discussion of the advantages of branch banking in the United States is and probably always will be purely academic. Politically it stands no chance whatever. It is a mistake, however, to assume, as some people do, that a proposition to create a central bank of issue under government control can never receive approval. This country has never had any experience with such an institution, for the government had practically no voice in the management of the First and Second Banks of the United States. If the bankers of this country can be made to understand that the government, by engaging in the banking business in some such way as is suggested by Mr. Warburg, will be able to guard and promote the financial interests of the people, helping rather than hurting existing banking institutions, and giving our banking

system a unity and stability it now lacks, the idea will speedily win favor with bankers and then with politicians.

There is a double banking problem in the United States: (1) a more elastic currency; (2) a better control of loanable funds. The average banker in the United States does not clearly see the connection between his lending power and the savings of the people. He measures his lending power by the amount of his cash on hand plus his credit balances in other institutions. On account of his isolation he is familiar only with the needs of his own community and is incapable of forming an accurate judgment with regard to the demand for and supply of capital in the country as a whole. Hence at times, governed purely by local conditions, he makes advances boldly when general financial conditions demand that he be cautious and conservative. A central bank of issue with branches doing business in all the important cities, would serve, not merely as a clearing house for bank notes but also as a clearing house of information with regard to the country's financial needs and prospects. In my opinion the subject of banking reform is one to which the economists of the United States ought to give most serious attention. Economists and practical bankers, working together, ought to be able to develop a system which will forever prevent the recurrence of such a panic as that of October, 1907.